

THE DIVIDEND PAYMENT POLICIES OF SELECTED LISTED COMPANIES IN BOTSWANA

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Abstract: Dividend policy is an important and fascinating subject in corporate finance. Many researchers have provided insights into the issue of dividend policy and why it is an important area in corporate finance. However, the issue of whether there is an optimal dividend policy is still a subject of on-going debate. It has been found that dividend policy is important because of the effect of its information on outsiders regarding future prospects of the firm, its impact on the firm's capital structure, investment opportunities and stock price.

This is an investigative study of the dividend policies of four listed companies in Botswana. The focus of this study is to examine the constancy or otherwise of dividends per share relative to the firms' earnings. The study also examines the theoretical basis for the selection reflected by the price/earnings ratio.

The findings of the research reveal that the selected companies had dividend policies that they adhered to and that they believed would maximise their shareholders' wealth. The firms use a blend of the residual dividend policy and the constant and steadily increasing dividend policy.

INTRODUCTION

Dividends usually refer to cash distribution of earnings to the owners of the company. A dividend policy determines the division of earnings between payments to the stockholders and reinvestment in the firm. A firm that adopts a high dividend payout ratio will have less funds available for reinvestment and will have to raise new capital and incur transaction costs or forego some profitable investments. There is a trade-off between future growth and a high dividend payout ratio. Dividend policy is an important and controversial subject in corporate finance. Some researchers consider dividend policy to be a passive variable in the decisions that optimise shareholders' wealth; that is, it is arrived at after the financing and investment decisions have been taken. Others consider dividend policy to be an active variable of equal importance to financing and investment decisions. A lot of research aimed at providing insight into the impact of dividend policy on the value of the firm has been done, but many

issues surrounding dividend policy are still unresolved.

According to Saxena (1999), the subject of dividend policy is important for several reasons. Firstly, researchers have found that a firm's dividend policy is important because of the signaling effect it can have on outsiders. Dividend payment policies do signal information to the market on the future stability and growth prospects of the firm. Secondly, it has been established that dividends play a role in a firm's capital structure. Retained earnings are one of the most significant sources of funds for financing corporate growth. Dividends constitute cash outflows that reduce the funds available for reinvestment. A firm can decide to pay out a substantial amount of its earnings in dividends and borrow the funds required to finance its capital budget or it can retain most of its earnings for reinvestment. The strategy adopted will have an impact on its capital structure and investment decisions. Lastly, it has been found that the firm's value is influenced by its dividend pattern. As depicted by the Gordon's valuation model, the price of a firm's stock is equal to the sum of the present value of its expected future dividend stream.

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Theoretically, the optimal dividend policy is the one that will maximise the price of the firm's stock and simultaneously increase the firm's value.

There are four main basic methods that can be used to pay dividends, although variations of these basic types do exist. These methods rest on various dividend theories. In this study, three main theories are considered in support of the dividend payment policies. While this study does not aim at testing the soundness of the dividend theories, it would be impossible to discuss the optimality of dividend payment policies without referring to the dividend theories. It has been found that the three dividend policy theories offer conflicting recommendations, based on differing assumptions, on what the optimal payment policy should be.

The Objectives of the Study

The major objective of this study is to establish whether the dividend payment patterns of the selected companies show the adoption of a particular dividend policy and the effects of these policies on market expectations as measured by the price/earnings ratios. The study will also investigate the relationship between dividends per share, earnings per share, dividends cover and the price/earnings ratios of the selected companies. Finally, the paper will evaluate the dividend policies adopted by the selected companies based on available literature and make recommendations.

Scope of the Study

A lot of research has been done in the field of dividend theory and policy. However, nothing is yet published on the dividend policies of Botswana enterprises. Much of the published research involves some very advanced statistical techniques that at this particular juncture may not be suitable for the purposes of this study. Furthermore, it is known that these techniques

make use of data that is not readily available in Botswana. For this reason, the data collected had to be in line with what was available. This research is aimed mainly at establishing the dividend patterns of the selected firms and is not intended to delve into an investigation of the soundness of the factors that influence the selection of the particular policy.

LITERATURE REVIEW

Today it is readily acceptable that a company is an artificial legal entity, separate and distinct from its owners. The shareholders for the most part do not get involved in the operational aspects of the company, leaving these to managers who are charged with stewardship. The shareholders expect to receive a return on their investment. The total return includes a dividend yield, the actual dividend determined by the value of the investment; the actual dividend received by the value of the investment, and capital gains yield, which result from an appreciation of the value of their shares. Potter-field (1994) argues that the objective of the firm should be to maximise the present value of future dividends and the appreciation in the price of its stock. He also argues that theoretically investors should be indifferent as to whether the company pays a dividend or not. This is so because when a company pays a cash inflow it is offset by a decline in the value of its shares which should increase to reflect the increase in present value of the expected future cash flows generated by the reinvestment of the retained profits. In practice this is not so. Potter-field also argues that, for many companies, payment of a regular cash dividend tends to have a favourable effect on share prices over a period of time. Hence the issue of why companies pay dividends and why they adopt a particular policy is still a puzzle.

DIVIDEND THEORIES

At this juncture it is appropriate to look at the dividend theories that have been put forward

by researchers in the field in an attempt to establish the relationship between a firm's dividend policy and its value. Three prominent theories will be discussed.

The Dividend Irrelevance Theory

This theory was put forward by Modigliani and Miller (M & M) in 1961. They proved under very restrictive assumptions that dividend policy was irrelevant and had no effect on the value of the firm. They suggested that shareholders would be indifferent to dividend payment and capital gains and a payment of dividends would not therefore alter the total value of the company. However, the M & M position presents some limitations. Their theory can only be applicable to the following unrealistic assumptions.

- That there are zero personal or corporate income taxes;
- That there are zero floatation and transaction costs;
- That there is independence between dividend policy and equity costs;
- There is symmetric information; and
- That the firm's capital investment policy is independent of its dividend policy.

These assumptions imply that a firm would be operating in a perfect market and do not hold water in the real world.

The Bird-in-the-Hand Theory

A different point of view is expressed in Gordon and Lintner's "Bird-in-the-Hand Theory." This theory focuses on M & M's assumption that the dividend policy does not affect the rate of return on capital. Gordon and Lintner argue that the cost of equity increases as the dividend payout is reduced because investors are more sure of receiving dividends than they are of receiving capital gains resulting from retained earnings. M & M refute this statement by arguing that investors will reinvest their

dividends in the same firm or similar securities; and that the riskiness of the firm's cash flow is a function of the firm's assets.

The Tax Differential Theory

This theory was put forward by Farrar and Selwyn in 1967 and modified by Brennan in 1970. It is based on the fact that capital gains are taxed at a lower rate than dividend income. Therefore it suggests that investors would require a higher rate of return on stocks of firms with high dividend payout ratios than they do on stocks of firms with low payout ratios. Under the tax laws applicable in many countries, capital gains are not taxed until one's shares are sold and there are no taxes accruing to an investor who holds the shares till death.

These preferences are noted in companies that have wealthy investors who tend to treat the firm as "incorporated cash boxes," a term that loosely refers to the phenomenon observed when investors choose to invest in companies where their earnings are retained and reinvested so as to carry a lighter tax burden.

To date these theories represent the basis for continuing debate. According to M & M there is no optimal dividend policy. Gordon and Lintner, on the other hand, suggest that a high dividend payout would be preferred, whereas the tax preference theory suggests that a low dividend payout would be preferred. Empirical testing has not produced results for the theory to be correct.

In addition to the above theories, some researchers focus on the informational content of dividends and the clientele effect. Baker *et al* (1985), in their survey of management views on dividend policy, concluded that dividend policy affects a firm's share price due to its signaling and clientele effect. An announcement of a dividend sends a signal to outsiders on the future earnings prospects and stability of the firm. A firm will adopt a dividend policy that will send positive signals and attract the correct clientele.

DIVIDEND PAYMENT POLICIES

The dividend theories give prescriptions on how firms should determine their dividend policy. However, in practice firms adopt one or a mixture of the four policies which are discussed below.

Constant Payout Ratio

Under this policy a constant fixed percentage of annual earnings is paid to the shareholder. Dividends per share are a function of earnings. In periods of buoyancy, a company would afford to pay higher dividends per share. However, floundering profits would lead to a lesser amount of dividends per share even though a constant percentage was maintained. This policy results in fluctuating dividends per share and unstable investment income and is followed by very few firms.

Constant of Steadily Increasing Dividends per Share

This is considered the best policy and is adopted by many firms. Under this policy, a fixed pura amount is paid to the shareholders each period. This procedure suggests to shareholders that a regular dividend will be maintained and that earnings will be sufficient to pay it. The amount is increased when there is a high expectation that future earnings can sustain the increased dividends. Firms strive not to reduce the annual dividend. Such a policy will send a positive signal to investors and results in stable investment income. In order to maintain the time value of money, firms adopt a policy of paying constantly increasing dividends per share. The philosophy behind this policy is to provide stable but steadily growing dividends. Many researchers are of the opinion that the adoption of this policy would maximise the price of a firm's stock (Brigham & Gapenski, 1994).

Low Regular Dividend Plus Extra Dividend Policy

Under this policy a firm pays a low dividend per share on a regular basis and then pays out

extra amounts as a bonus when excess funds are available. Investors will prefer this policy since even in times of low profits, they are assured a minimum amount of dividend. This policy is followed by firms with volatile earnings. As a cross between the constant plus dividend and the constant payout, it achieves two things at once; retention of earnings to drive expansion and at the same time to enable the firm to pay dividends in a manner that will send out positive signals to current and potential investors.

Residual Dividend Policy

This policy suggests that dividends are a passive variable (Correia *et al* 1993). Dividends are paid out of leftover earnings after the firm has financed its optimal capital budget. It is based on the premise that investors prefer the firm to retain and to reinvest earnings rather than to pay them in dividends. The driving philosophy of this policy is that internal financing is superior to external financing. It is less expensive to finance with retained earnings than to raise external funds. Hence using the residual dividend policy results in lower cost of capital. Firms whose shareholders favour retention and reinvestment of earnings tend to employ this approach. The pure residual approach results in fluctuating and highly unpredictable dividends per share which can lead to loss of investor confidence. To overcome the problem of unstable dividends, some firms follow a smoothed residual dividend policy, whereby the firm strives to reduce the variability of the dividend payments. Brigham & Gapenski (1994) suggest that the residual policy can be used as a guide for establishing the long - term target payout ratio, but should not be adhered to year by year.

Factors That Influence Dividend Policy

The dividend policy that a firm eventually selects will ultimately depend upon the impact of a number of factors. A study conducted by Baker, Edelman and Farre (1995) (1985), revealed that managers considered the anticipated level of a

firm's future earnings, the pattern of past dividends, the availability of cash and concern about maintaining or increasing the stock price, to be the main determinants of their dividend payout policy. In a survey of bank executives in Botswana, Letsile (1999) found that the dividend payout was based on profitability and in some cases of some foreign-owned banks, on instructions from head office. It can be seen that a number of factors need to be considered when determining dividend payout policy. Harvey (1995) groups these factors into two categories; those that favour a high payout ratio and those that favour a low payout ratio.

Factors Which Favour a Low Payout

These include factors that influence the firm to retain most of the earnings and payout a small percent in dividends. These factors include: personal taxes, transaction costs of raising finance, asset expansion, unstable earnings, legal restrictions and the inability to raise funds on the capital markets.

Factors Favouring High Dividend Payout

The factors that are conducive to a high dividend payout ratio include: informational content of dividends, stable earnings, lack of profitable investment opportunities and well-developed capital markets.

The effect and magnitude of the impact of the above-mentioned factors will differ from one firm to another. In addition, each firm will select a dividend policy that will attract its clientele.

METHODOLOGY

Data was collected through secondary and primary data collection methods. A combination of literature review and personal interviews was used. The annual reports of the selected listed companies provided the bulk of the data for analysis. Other sources of information included: books, journals, periodicals, CD-Rom facilities and the Internet. The information collected was used to support the empirical findings and

recommendations. Essential market information was also collected from the Botswana Stock Exchange.

Since financial analysis uses historical data, it was decided that personal interviews would be used to clarify the current position of the selected firms given the analysis of their historical financial information. To this end, face-to-face interviews were conducted in all the selected companies. The respondents were designated personnel in the Finance Departments of the selected companies. Telephone interviews were also conducted in the event that there was a need for clarification of the responses obtained through the personal interviews.

Sample Selection

A quota sample selection plan was adopted for the study since the data analysis is non-probabilistic in nature, as it had already been decided that the findings from the investigation could not be applied generally across all the companies because they differ across various lines. These consisted of the 13 companies listed on the Botswana Stock Exchange. While it is not a large stock exchange by international standards, studying all the companies would have been too wide a scope. The following four companies were selected for an in-depth analysis.

- Standard Chartered Bank Botswana (Pty) Ltd.
- First National Bank of Botswana (Pty) Ltd.
- INCO Holdings (Pty) Ltd.
- PEP Botswana Holdings (Pty) Ltd.

Limitations of the Study

Empirical testing carried out by various researchers have shown that none of the three main dividend theories is an "authority" in determining of an optimal dividend policy. This is because that, if a dividend theory is to be tested through a statistical survey, sample firm must be similar in all respects except in their dividend payment policies. However, it is almost

impossible to find companies that satisfy this requirement. In addition, the cost of equity of a firm must be measured with a high degree of accuracy, given that, the costs of equity are not precise. Researchers often have to use historical earned rates of return in order to determine market riskiness and thus cost of equity. Historical data is not a good basis for establishing which conditions lead to optimality in the light of market volatility.

Due to these limitations, it was decided that instead of running a comparison of various companies, the study would restrict itself to studying the selected companies in order to determine the dividend payment policy of each company. Comparison amongst the companies would be based on general observations only.

ANALYSIS AND FINDINGS

For each company the earnings per share (EPS), dividends per share (DPS) and price/earnings (P/E) ratios were calculated. The DPS, EPS and P/E ratios were analysed over a five-year period, from 1993 to 1997, to establish trends and the relationship between dividends, earnings per share and the price/earnings ratios.

Dividend Per Share (DPS)

This ratio simply apportions the total dividends paid out by the company to each ordinary share issued. The data was tabulated in two formats, one showing the annual nominal dividend per share in thebe and the second showing the indexed dividend per share, with the base year being 1993. Using indexed dividends simplified the task of discussing in general terms the changes in dividends. The nominal DPS and the indexed DPS are shown in Tables 1 & 2 in the Appendix.

Earnings Per Share (EPS)

SSAP 3 defines EPS as the profit attributable to each ordinary share, expressed in thebe, based on profit for the period after deducting tax, minority interest, extraordinary items and

preference dividend divided by the number of equity shares in issue and ranking for dividends over the period. This is the most frequently used of all the accounting ratios and is generally felt to give the best view of performance. It indicates how much of a company's profits can be attributed to each ordinary share in the company. The nominal EPS and indexed EPS are shown as Table 3 and 4 in the Appendix.

P/E Ratio

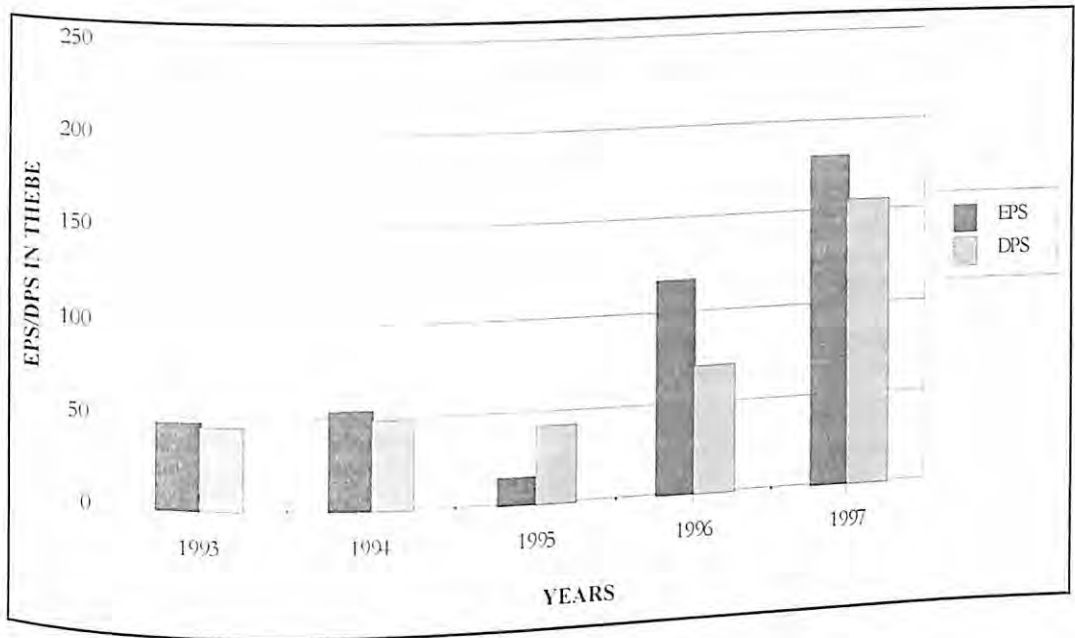
This ratio shows the amount that investors are currently willing to pay per pula of current earnings. The P/E ratio is a useful indicator of how the stock market assesses the company. It is directly related to a firm's growth prospects and enables potential investors to assess whether the expected future earnings make the share a worthwhile investment. The P/E ratios are shown in Table 5 in the Appendix.

To enrich the findings further, the dividend cover was calculated for each firm for the five-year period. The dividend cover shows earnings as a multiple of dividends. A high dividend cover implies that the chances of a dividend cut are remote because earnings have to fall substantially before the firm fails to pay the set dividend. This information is shown in Table 6 in the Appendix.

FINDINGS

The Standard and Chartered Bank of Botswana (Stanchart)

The bank's objective is to build shareholders' wealth through the creation of higher revenues, lower costs, strong capital ratios and improved shareholder returns (Annual Report 1995). The EPS and DPS trend is shown in Fig. 1 below. The bank showed growth in DPS in the five years studied. The DPS was 36 thebe in 1993 but in 1997 it had increased to 155 thebe, reflecting a growth of 333%. However, the year - to - year growth was gradual. The 1994 DPS



Source: Annual Reports

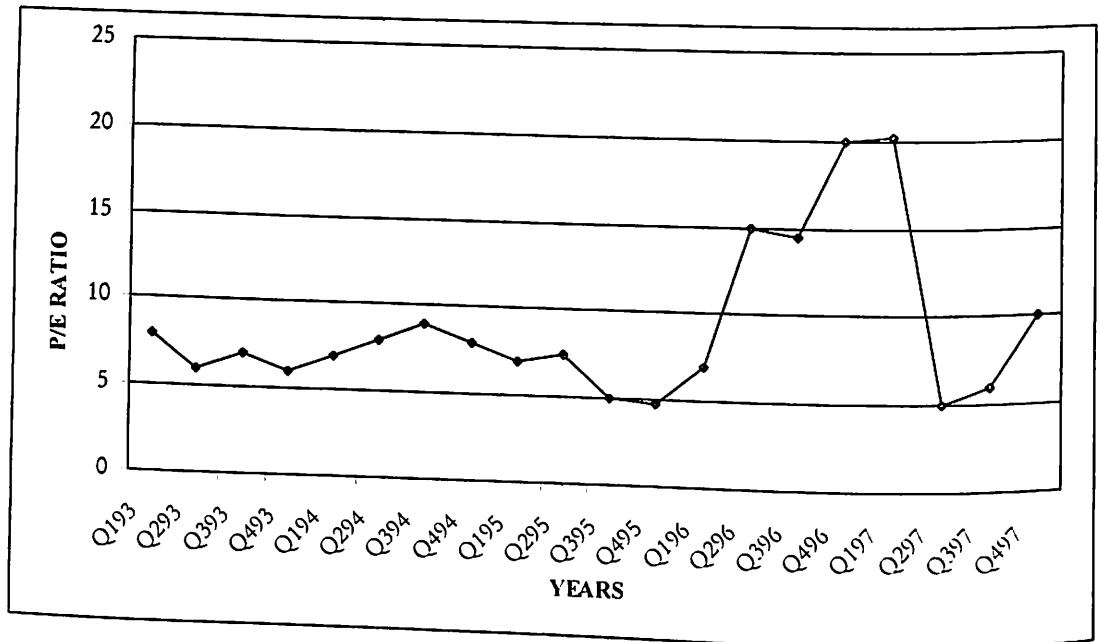
Fig. 1: *Standard and Chartered Bank EPS/DPS 1993 - 1997*

reflected an increase of 33% over the 1993 DPS. In 1995 the DPS was maintained at the 1994 level. This is due to the fact that the company had experienced a fall in gross earnings and EPS. In 1995 DPS exceeded EPS. This shows the bank's desire to assure its shareholders of a stable dividend income. Following good operating results, the bank was able to increase the dividend by 46% over the 1995 level. The 1997 dividends showed an increase of 161% over the 1996 DPS. This huge increase in dividends was possible due to an increase of 46% in operating income before interest and an increase of 50% in EPS. The directors also felt that sufficient level of earnings had been retained in the business for future growth due to the EPS of 191.1 achieved in 1997.

This reflects the directors' confidence in the underlying profit performance of the bank notwithstanding substantial one off charges. The indexed DPS indicates an increase of about 265 points from 1993 to 1997. Successful cost

cutting and efficient use of resources led to increased return on shareholder wealth.

The indexed EPS of the bank show a pattern similar to that of the DPS. EPS increased by 347.3 points from 1993 to 1997, reflecting a good profit position. In 1995, the bank's trading results reflected a decline of 57% in after-tax profits, but the bank maintained the dividend at its 1994 level. However, in 1996, the bank showed an increase of 33.9% in profits after tax over 1995, but it increased the DPS by 46%. As depicted in Fig. 2, the P/E ratio was 8.2 times in the first quarter of 1993, but it dropped to 6.3 times by the end of the year. The P/E ratio picked up in the second quarter of 1994 reaching a high of 8.8 times during the third quarter before dropping to 6.7 times during the first quarter of 1995. The P/E ratio was at its lowest level, 5.5 times, in the fourth quarter of 1995. During the first quarter of 1996, it rose to 7.3 times and jumped to 15.0 times during the second quarter of 1996. It dropped to 14.6



Source: Compiled from Botswana Stock Exchange Data

Fig. 2: Standard and Chartered P/E Ratios 1993-1997

times in the third quarter of 1996 before rising to 20.1 times in the fourth quarter. The ratio rose to 20.3 in the first quarter of 1997 but it declined to 5.0 times during the second quarter of 1997. During the third quarter of 1997, the P/E ratio rose to 5.8 times and by the end of the year it stood at 9.6 times. Even though shareholders experienced a steady increase in DPS, the P/E ratio fluctuated. The lowest P/E ratio was recorded in the fourth quarter of 1995. The market reaction could have been triggered by the fact that the bank was expecting to make a loss for the year and shareholders were not sure of receiving a dividend. However, the company maintained the previous year's DPS thereby triggering investors' confidence. This positive signal led to a surge of the P/E ratio to its highest level in 1996. It also appears that the increase was the market response to positive information signaled in the preceding year's financial statements, specifically the successful restructuring program.

The P/E ratio followed the same fluctuations seen in the EPS patterns but was not completely in sync. The price of the firm's stock also saw a steady increase from P3.90 in 1993 to P14.75 at the close of 1997.

It can be seen that DPS followed EPS except in 1995 when the EPS was lower than the DPS. The company used its reserves to pay dividends. The DPS grew from year to year except for 1995 when the company maintained the previous years DPS due to a drop in EPS. The bank maintained a low dividend cover. It ranged between a low of 0.65 times and a high of 1.97 times.

The First National Bank

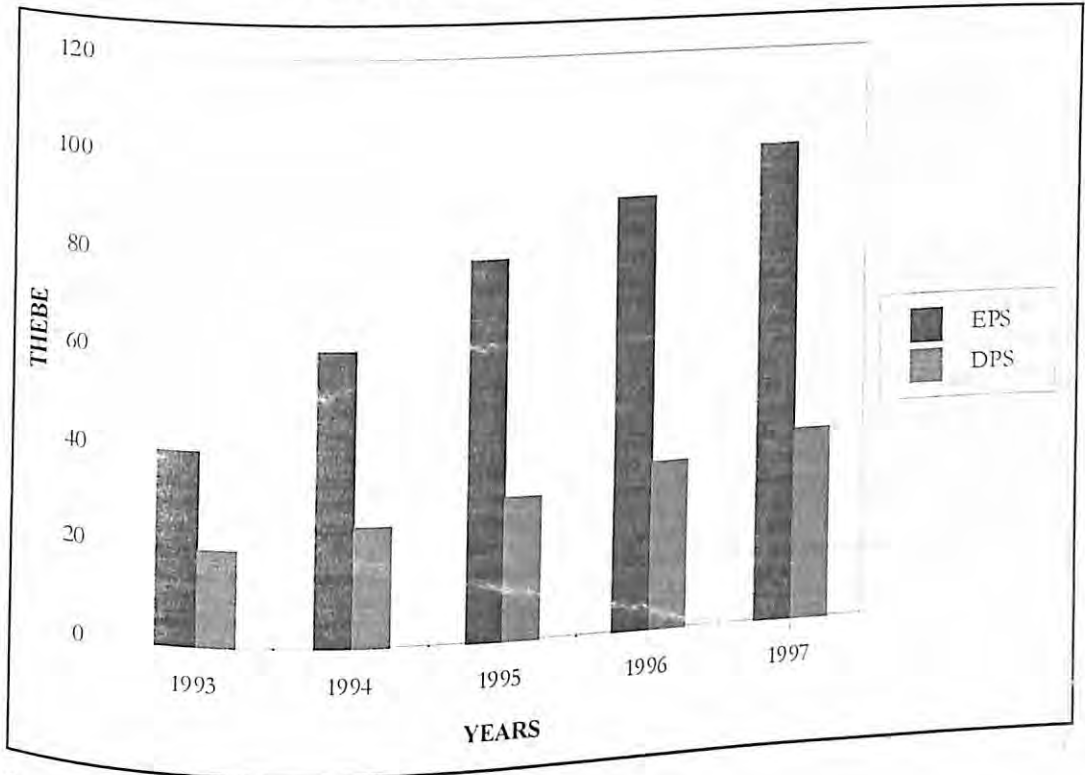
The bank's policy is to retain profits for future growth (Annual Report 1994), hence the bank maintains a dividend cover of 3 times. With the exception of 1993, when the payout ratio was 40%, the payout ratio fluctuated between 31.5%

and 32% between 1994 and 1997. The bank's EPS/DPS pattern is depicted in Fig. 3. The bank managed to maintain a steadily growing DPS together with a rather prudent dividend payment policy.

In 1993 DPS was 17 thebe, increasing to 20 thebe in 1994, 24 thebe in 1995, 28 thebe in 1996 and 33.5 thebe in 1997. The annual increase ranged between 16% and 19.6%. Hence the dividend payment patterns reveal a steady increase in DPS with the 1997 DPS being almost

income and assets. Despite these expansion measures, the bank maintained steady growth in earnings and dividends.

The bank's P/E ratios are depicted in Fig. 4. The P/E ratio was 7.0 times in the first quarter of 1993, but it fell to 6.0 in the second quarter, increasing to 6.4 times in the third and fourth quarters before falling to 6.3 times in the first quarter of 1994. The P/E ratio increased to 7.7 times during the second quarter of 1994. This increase continued in 1994 and reached a



Source: Annual Reports

Fig. 3: *First National Bank of Botswana EPS/DPS 1993-1997*

double the 1993 DPS. The increase in DPS is in line with growth in earnings.

First National Bank also completed the takeover of the Financial Services Company of Botswana in late 1993 and acquired the entire issued share capital of Zim Bank Botswana Limited in late 1994. These acquisitions were cited as the reason for the increase in the bank's

peak of 9.6 times during the first quarter of 1995. From there the ratio started to decline reaching its lowest level of 5.2 times in the third and fourth quarters of 1996. The ratio picked up slowly during the first three quarters of 1997, but in the fourth quarter the ratio almost doubled to reach 10.8 times.

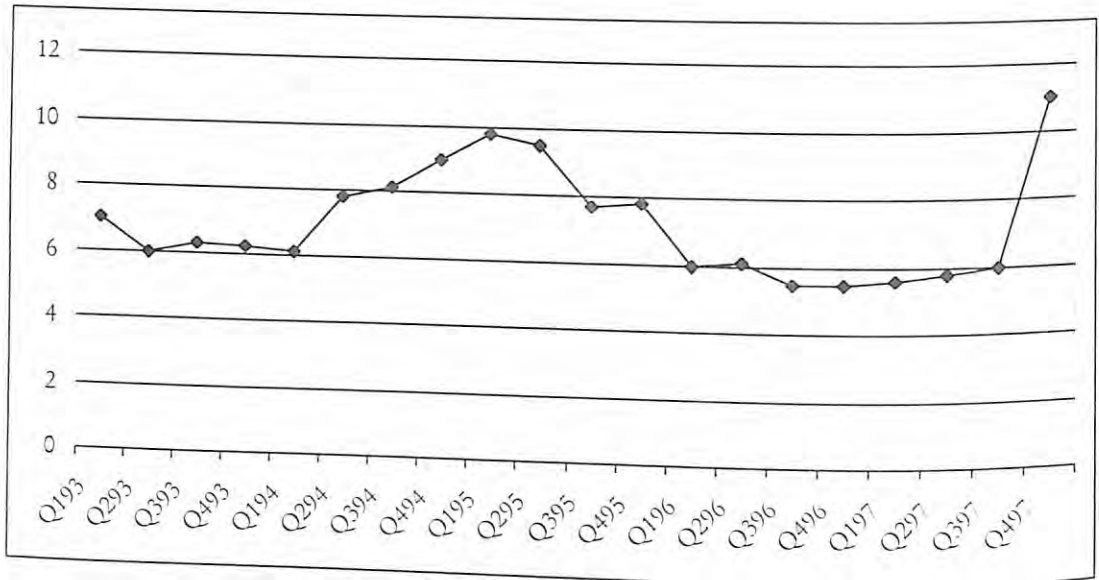


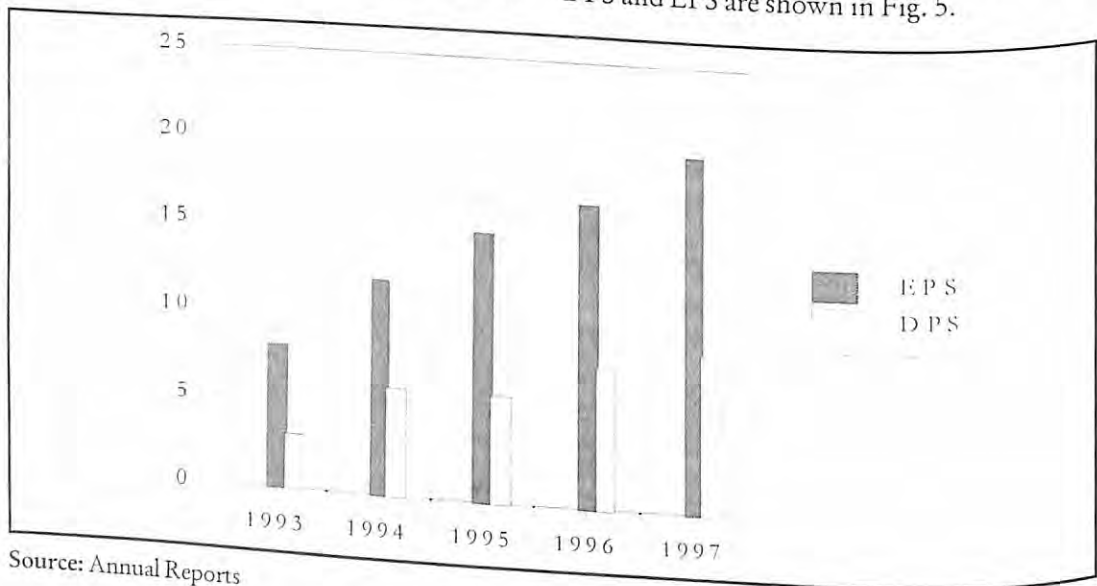
Fig. 4: First National Bank of Botswana P/E Ratios 1993-1997

The price of the bank's shares also increased from P2.65 at the end of 1993 to P8.75 at end of 1997. It was also found that over the years profits available for distribution also grew with the 1997 profits reaching 5 times the 1993 level. It achieved a steady growth in dividends while maintaining a constant payout ratio. The bank

has a high earnings retention rate because it anticipates further future growth.

INCO Holdings

This is a Botswana - based holding company which provides management services to a group of subsidiaries in the security sector. INCO'S DPS and EPS are shown in Fig. 5.



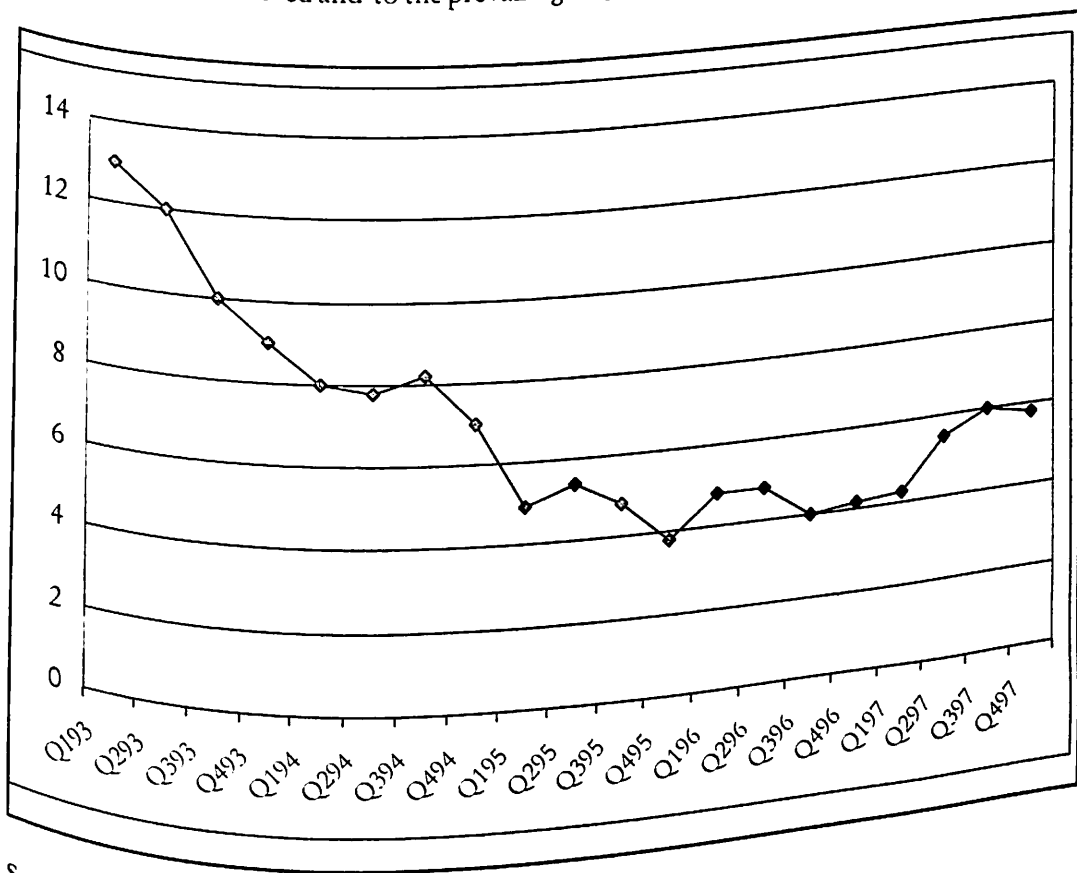
Source: Annual Reports

Fig 5: INCO Holdings EPS and DPS 1993-1997

INCO's net profits after tax grew steadily each year. By 1997 profits had increased by almost 200% over 1993 profits. The firm's DPS grew, albeit modestly, over the period. In 1994 the DPS increased by 100%, rising from 3 thebe in 1993 to 6 thebe. In 1995 the dividend increased by a meager 3%, but it continued to increase steadily and by 1997 it was treble the 1993 level. The EPS shows a modest increase from year to year. The 1997 EPS shows a 155% increase on the 1993 figure. The company maintained a steady dividend cover of 2.4 times except in 1997 when the dividend cover was 2.5 times. In 1996 INCO Board decided not to engage in rapid expansion and diversification due to the high levels of investment and operational risk involved and to the prevailing

poor economic conditions at the time (Annual Report 1996). This move led to more funds being available for distribution to shareholders.

Fig. 6 shows the company's P/E ratios. The P/E ratio was 12.9 times during the first quarter of 1993, but it decreased constantly and by the end of the year it was 8.9 times. The decline in P/E ratios continued in 1994 and 1995 and were at their lowest level of 3.5 times in the fourth quarter of 1995. The ratios picked up, though with some fluctuations and during the third quarter of 1997, were 6.0 times. However, they decreased to 5.7 times during the last quarter of 1997. INCO's payout ratios fluctuated around a range of 35-44% in the five year period. But at the same time, the DPS grew modestly from year to year.



Source: Annual Reports

Fig. 6: INCO Holdings P/E Ratios 1993-1997

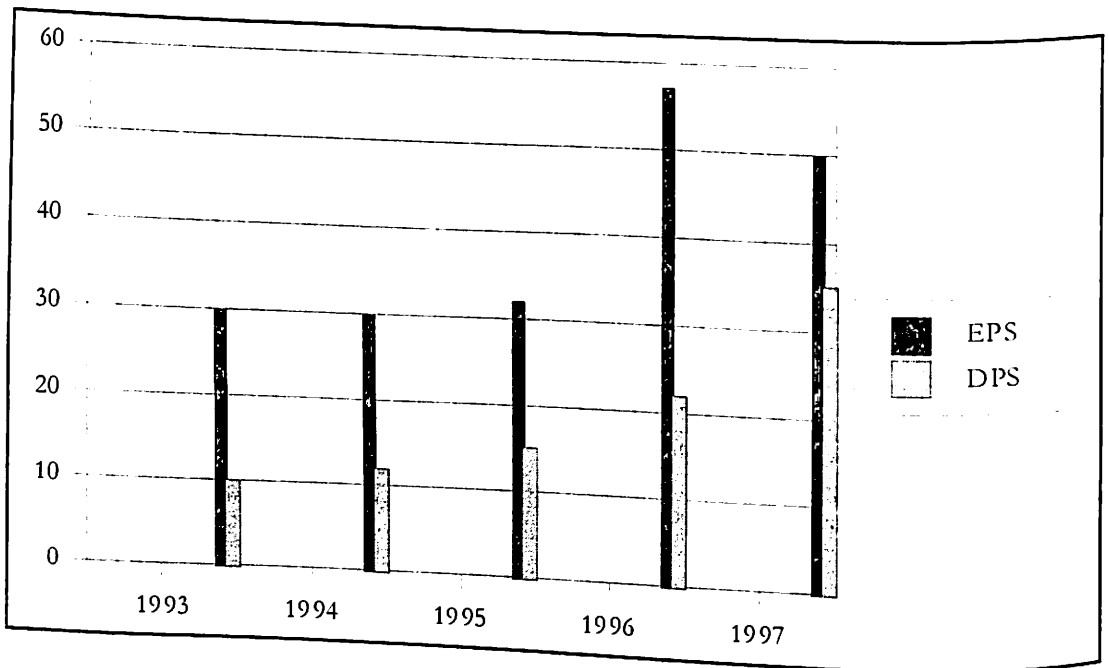
The P/E ratios decreased with some upward fluctuations in some years even though both EPS and DPS were increasing.

PEP Botswana Holdings

PEP is a retailing company, with a mission of providing shareholders with a secure and growing investment. PEP's EPS and DPS data are shown in Fig. 7 below.

of the financial year from February to June thus it reflecting results for 16 months.

In 1997, growth in DPS was 48% even though EPS declined by 12%. The dividend cover was 2.32 and 2.31 in 1993 and 1994 respectively. In 1995 the dividend cover was 2.17 and in 1996 the cover raised to 2.48 due to the large increase in after - tax earnings. In 1997, the regular dividend of 34 thebe per share represents a cover of 1.47 times. The directors



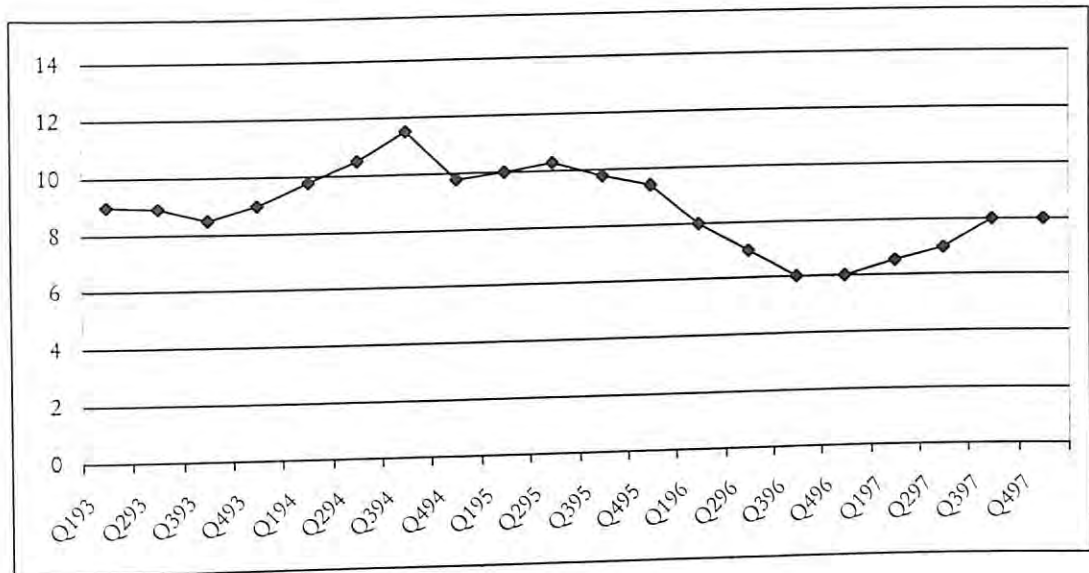
Source: Annual Reports

Fig. 7: PEP Botswana Holdings DPS and EPS 1993 - 1997

PEP's EPS experienced modest and steady growth from 1993 to 1995. In 1994 EPS increased by 6%, while in 1995 growth in EPS was 5%. The 1996 EPS was 64% higher than the 1995 figure; however EPS dropped by 12% in 1997.

PEP's DPS grew steadily from 1993 to 1997. It followed the growth pattern in EPS. In 1993 DPS was 13.5 thebe, it increased by 7.41% in 1994, by 7.41% in 1994, by 10% in 1995 and by 44% in 1996, reflecting the hefty growth in EPS. This increase was largely due to the change

PEP's P/E ratios are depicted in Fig. 8. The P/E ratios fluctuated gently over the period. In the first and second quarters of 1993, they were 9.0 times, decreasing to 8.6 times during the third quarter of 1993. The P/E ratios started a steady increase from the fourth quarter of 1993 reaching a high of 11.4 times in the last quarter of 1994, after which they fell to 9.7 times in the first quarter of 1995. They rose again to 10.2 times in the third quarter of 1995. In 1996 and 1997 the P/E ratios maintained a downward slide reaching a low of 6.2 times during the



Source: Annual Reports

Fig. 8: PEP Botswana Holdings P/E Ratios 1993 - 1997

fourth quarter of 1996 and its first quarter of 1997. They started to increase again reaching 8.0 times in the last quarter of 1997.

Summary of Findings

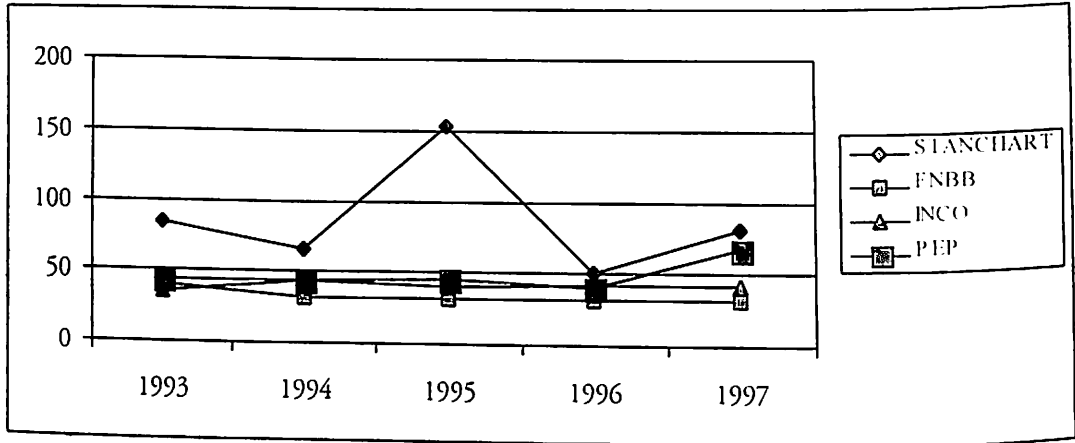
One of the major problems in analysing dividend patterns of companies is that no two are alike. All differ with numerous variables. In a statistical survey it is difficult to come to some general conclusions from observations. In a non-statistical study this difficulty is magnified. Nevertheless some interesting observations were made across the board.

The dividends of all four companies followed earnings. With the exception of Standard and Chartered (1995) and PEP (1996), the companies recorded a steady growth in the EPS. The DPS of the firms grew annually over the period studied, with the exception of Standard in 1995, when the dividend was maintained at the previous year's level.

The companies seem to follow the regular and steadily increasing dividend policy combined

with the smoothed residual dividend policy and the low regular plus extra policy. FNBB showed an increase in DPS as well as maintaining a constant dividend payout ratio. The dividend payout ratio was closely linked to the companies' investment and growth prospects. The annual reports reflected the directors' determination to maintain enough funds for growth. In the case of PEP, excess cash not required for investment was distributed as a bonus dividend in 1997.

The payout ratios of the selected companies are shown in Fig. 9. It can be seen that FNBB, INCO and PEP maintained almost constant payout ratios even though DPS increased constantly. The payout ratios ranged from 35% to 45%. It would appear that the firms set a target range for the payout ratio that allows the firm some latitude to increase annual dividends. The payout ratio for Standard and Chartered Bank was the highest and also the only one that fluctuated by a large margin. The large swing between 1994 and 1996 was due to the fact



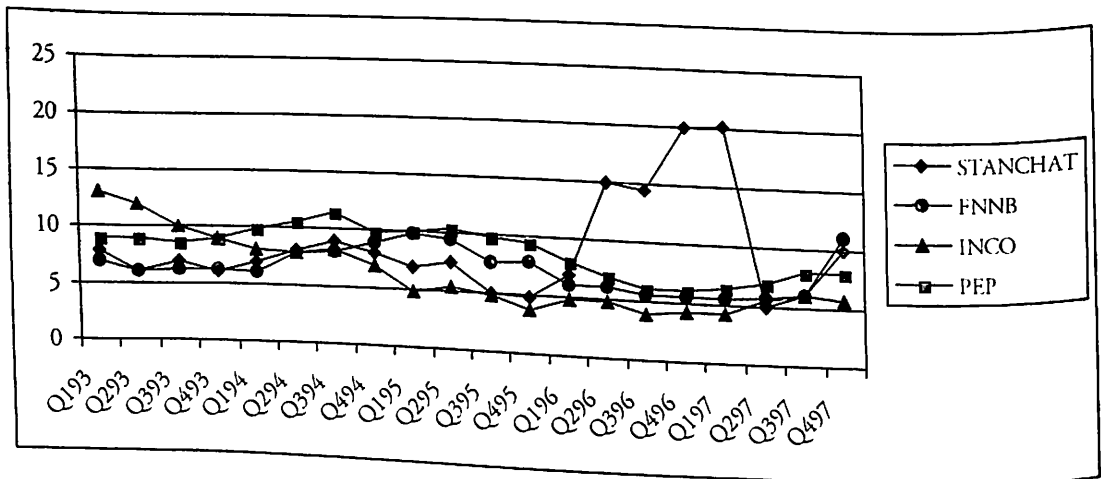
Source: Annual Report

Fig. 9: Dividend Payout Ratios

that the bank suffered a decline in EPS in 1995, but maintained the dividends at the previous year's level. In the other years the payout ratio was between 51% and 84%.

All companies cited difficult economic conditions within which their operations were carried out. These affected the companies' ability to borrow at attractive rates and therefore pushed the company to use internal sources of

financing—namely retained earnings. It is therefore interesting to note that on the whole these companies continued to post satisfactory results and growth in earnings and dividends. Improved profits for all the companies can be attributed to the effects of strict cost control and the reduction of the effective corporate tax rates.



Source: Compiled from Botswana Stock Exchange Data

Fig. 10: P/E Ratios 1993-1997

With the exception of Standard and Chartered Bank, all the companies showed a slump in P/E ratios in 1996 and early 1997. This coincides with the period of poor economic conditions and slow recovery that was cited by all companies as being the prevalent trading conditions. Even though EPS and DPS of all the companies increased steadily over the years, the P/E ratios fluctuated. It would appear that investors also consider other factors when evaluating a company and how much they are willing to pay for their shares.

CONCLUSIONS AND RECOMMENDATIONS

This study began with the premise that the selected companies have dividend payment policies that they adhere to. It was also presumed that the dividend payment policy adopted by a company would be one subjecting shareholders to as little risk as possible, by signaling the most accurate information about the company's future prospects, with the P/E ratios reflecting this sentiment. A review of the generic dividend payment policies suggests that the constant and steadily increasing dividend policy is the one that leads to the maximisation of the firm's share price. It is also recommended that firms in an unstable industry, like fashion and clothing, should adopt a policy of paying a low regular dividend plus a bonus dividend in good years. Due to the signaling effect of dividend announcement, firms strive to maintain the dividend at a constant level. They avoid reducing the annual dividend to avoid sending negative signals to shareholders about the firms, future earning prospects.

From the findings the following conclusions can be drawn:

- Management is concerned about dividend continuity;
- All the companies maintain a constant and steadily increasing dividend payment policy;
- All the firms express a desire to give their investors an increasing return on their investment;
- The dividend payment policy is highly

influenced by the firms' earnings and investment opportunities;

- The firms follow a policy of never reducing the annual dividend even in the face of bad trading results;
- With the exception of Stanchart, all firms experienced growing DPS over the five-year period;
- FNNB has the highest dividend cover due to its desire to retain funds for future growth. Stanchart has the lowest dividend cover;
- None of the firms use the pure residual dividend policy nor the pure constant payout ratio methods;
- The factors that affected the dividend payout appear to be in line with those cited in the literature review; and
- The P/E ratios do not reflect the DPS pattern. One would expect the P/E ratios to increase in line with growth in DPS. It looks like investors take other factors into consideration.

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APPENDIX 1

Table 1: Dividends per Share (Thebe)

	1993	1994	1995	1996	1997
STANCHART	36	40.8	40.8	59.5	155
FNBB	17	20	24	28	33.5
INCO	3	6	6.2	7.5	9.0
PEP	13.5	14.5	16	23	34

Source: Annual Reports of the Four companies from 1993-1997

Table 2: Indexed DPS

	1993	1994	1995	1996	1997
STANCHART	100	113.33	113.3	151.9	365.3
FNBB	100	117.6	141.2	164.7	197.1
INCO	100	200	206.7	250	300
PEP	100	107.4	118.5	170.4	251.9

Table 3: Earnings Per Share (Thebe)

	1993	1994	1995	1996	1997
STANCHART	42.7	61.8	26.6	117.2	191
FNBB	42	62	76	88	106
INCO	8.4	13.6	15.2	17.9	21.4
PEP	31.3	33.15	34.7	57.13	50.01

Table 4: Indexed EPS

	1993	1994	1995	1996	1997
STANCHART	100	144.7	62.3	274.5	447.3
FNBB	100	147.6	180.9	209.5	252.4
INCO	100	161.9	181.0	213.1	254.8
PEP	100	105.7	110.8	182.1	159.7

Table 5: Dividend Payout Ratio (%)

	1993	1994	1995	1996	1997
STANCHART	84.3	66.0	153.0	50.8	81.1
FNBB	40.0	32.0	31.5	31.8	31.6
INCO	35.7	44.1	40.8	41.8	42.1
PEP	43.0	43.7	46.0	40.0	67.9